

# Case Studies on Aviation Industry

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## OVERVIEW

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Sir Adam Thomson, the chairman of British Caledonian Airways once remarked, “A recession is when you have to tighten your belt; depression is when you have no belt to tighten. When you’ve lost your trousers – you’re in the airline business.”<sup>1</sup> This is an industry, which has lost more money than it generated since its inception. But against this backdrop, Herb Kelleher, started the Southwest Airlines and was highly successful. Its low-cost business model redefined the way the industry operated. Many tried to emulate the Southwest model, but only few could match its profitability. Already plagued by deregulation, competition and rising costs, the traditional players suffered a major blow with the 9/11 terrorist attacks.

Most flights remained grounded for days after the attacks. And when they flew again, the commercial aviation market was no more the same. The newly perceived risk in flying caused many people to avoid or reduce air travel. This initial panic died with time. But the new stringent security measures made air travel more cumbersome and time-consuming. Altogether, there was a negative shift in demand for air travel. And that too, when profitability had been an elusive goal for most industry players, given the highly cyclical and cost-intensive nature of the market. In fact, the revenue per passenger kilometer was already declining (Exhibit I) before the 9/11 attacks. The event significantly accelerated the impact of the existing trends like the global economic slowdown, rising fuel prices, safety concerns and the rise in the number of low-cost airlines.

Airlines struggled with decreasing load factor and increasing costs. Many were pushed into bankruptcy. Cost-cutting initiatives – like lay-offs, reducing airline capacity to align with the demand, deferring marketing expenses and cancelling plane deliveries – had become an industry norm. While the major airlines were having a difficult time, the low-cost ones like Southwest Airlines in US, EasyJet in UK and Ryanair from Ireland – showed robust growth in revenues and profits. Point-to-point network, online reservations, paperless tickets, secondary airports, no in-flight entertainment and no elaborate meals kept the costs in check and through lowest fares attracted passengers. The profitability attracted new players to the industry, where the entry barriers were already low, because of industry deregulation. The added capacity added to the competitive pressures. The question was: has the business model for commercial aviation changed permanently?

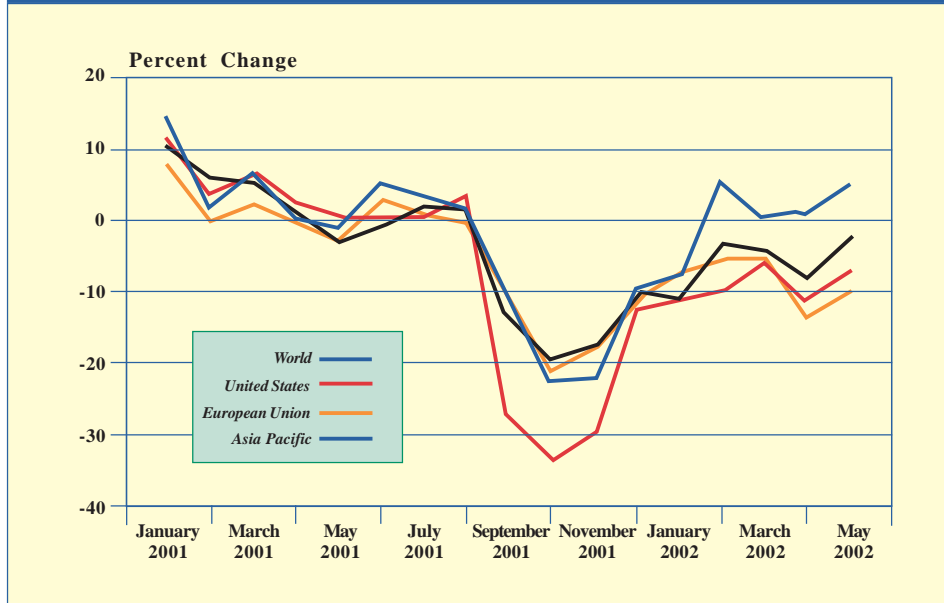
While many blame the added capacity, rising fuel prices, competition and labour problems for the woes of the aviation industry, the need was for an efficient business model. And that meant cost management through efficient operation management including fleet management (procurement of aircraft and its maintenance), reduced transit time and increasing the load factor.

“...An industry’s key success factors (KSF’s) are those competitive factors that most affect industry members’ ability to prosper in the marketplace... KSF’s by their very nature are so

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<sup>1</sup> “Great Aviation Quotes”, <http://www.skygod.com/quotes/airline.html>

**Exhibit I**  
**Revenue per Passenger Kilometer**  
**(January 2001 – May 2002)**



Source: International Air Transport Association

important to future competitive success that all firms in the industry must be competent at performing or achieving them or risk becoming an industry also-ran.”<sup>2</sup>

**Key Success Factors for Airlines<sup>3</sup>**

- **Attracting customers** – With the industry facing stiff competition, one of the ways of attracting customers is a lower ticket price per seat. Another way could be differentiating service offering to attract business and luxury travellers.
- **Promotion Effectiveness** – In an intensely competitive scenario, promotion becomes an effective tool for attracting customers. But promotional expenditure is not discretionary; hence promotion effectiveness becomes a critical success factor, measured by revenue passenger miles per promotion dollar.
- **Aircraft Utilisation** – The higher the aircraft hours per aircraft day, the better it is from the airline perspective, as it lowers the costs.

<sup>2</sup> Thompson, Arthur A., Jr., A. J. Strickland, and John E. Gamble. *Crafting and Executing Strategy: The Quest for Competitive Advantage – Concepts and Cases*. Boston, et al.: McGraw-Hill Irwin, 2005.

<sup>3</sup> McCabe Richard, “Airline Industry Key Success Factors”, <http://gbr.pepperdine.edu/064/airlines.html#mccabe>

- **Relative Load Factor** – It is calculated as the revenue passenger miles per available seat mile divided by the average load factor of the airlines in the industry. Higher is better from airline point of view.
- **Employee Productivity** – An effective way to control costs is by increasing the employee productivity, that is, available seat miles per employee.
- **Employee Morale** – Productivity is directly linked to the morale of the employees. Though employee morale is difficult to measure, it can be quantified in terms of their commitment to the work. Example, sum of lost bags per 1000 passengers and complaints per 100,000 passengers. Lower is better from both customer and airline perspective.
- **Operating Revenue** – It is measured as the total operating revenue per available seat mile, relative to average of the other airlines in the market. Higher operating revenue is better from airline perspective.
- **Operating Costs** – It is total operating costs per available seat mile. The lower the operating costs the better it is from the airline perspective.
- **Operating Margin** – It is the difference between the total operating revenue per available seat mile and the total operating cost per available seat mile. A higher value is always beneficial.
- **Relative Growth Rate** – Calculated as the available seat miles of the current period relative to the available seat miles comparable period, a year earlier. There should be a continuous progression in the relative growth rate to ensure profitability.
- **Equity Growth** – Equity growth rate shows investor's confidence in the company's philosophy and business model. Hence the higher the value, the better from an airline's perspective.
- **Debt to Total Assets** – A reasonably low ratio is preferred by most investors, and therefore, better for the airline.

*Case Studies on Aviation Industry* seeks to explore the challenges confronting the aviation industry and how the players are tiding over them. Each case study has a core concept, outlined in the following table.

Name of the Case Study	Geographical domain	Core Concepts
Airbus vs. Boeing: The Subsidy Wars	USA and Europe	<ul style="list-style-type: none"> <li>Subsidies and competition</li> </ul>
EADS in America: The Competitive Strategies	USA	<ul style="list-style-type: none"> <li>Competitive strategies in US defence market</li> </ul>
Boeing's Defense Deals and Ethical Issues	USA	<ul style="list-style-type: none"> <li>Political nexus and corporate governance issues</li> </ul>
Rolls Royce's Civil Aviation Business: "Customer-Driven" Growth Strategies	USA	<ul style="list-style-type: none"> <li>Profit pools</li> <li>Diversification and growth strategies</li> </ul>
BAA's T5: Novel Project Management	UK	<ul style="list-style-type: none"> <li>Risks in mega projects</li> <li>Project management</li> </ul>
Cost Advantages of Low-cost Carriers in USA	USA	<ul style="list-style-type: none"> <li>US domestic aviation market</li> <li>Business model of low-cost carriers</li> </ul>
Low-cost Carriers in Mexico: Growth Prospects and Concerns	Mexico	<ul style="list-style-type: none"> <li>Competition in the Mexican airline industry</li> <li>Growth prospects for low-cost carriers</li> </ul>
Low-cost Carriers in Asia	Asia (Thailand, the Philippines, Malaysia and India)	<ul style="list-style-type: none"> <li>Domestic aviation industry in some of the Asian markets</li> <li>The concept of national carriers</li> <li>Deregulation and its effect on industry dynamics</li> <li>Opportunities and challenges for low-cost airlines</li> </ul>
India's No-frills Airlines: No-profit Airlines?	India	<ul style="list-style-type: none"> <li>Revolutionary business concepts affecting the business prospects of traditional players in the industry</li> <li>Business and revenue model of low-cost airlines in India</li> </ul>
Eos Airlines, World's First All-business Class Carrier: Low-cost Model in Long-haul Air Travel?	USA	<ul style="list-style-type: none"> <li>Blue Ocean Strategy</li> <li>Viability and sustainability of a new business model</li> </ul>
Troubled Times at Air Canada	Canada	<ul style="list-style-type: none"> <li>Scanning the periphery – identifying signs before trouble</li> <li>Business transformation measures</li> </ul>
Growth Strategies of China Southern Airlines	China	<ul style="list-style-type: none"> <li>Leveraging government for growth</li> <li>Strategies for growth in domestic and international aviation business</li> </ul>

*Contd...*

British Airways' Willie Walsh: The New CEO's Challenges	UK	<ul style="list-style-type: none"> <li>• Sustaining leadership position in the industry</li> <li>• Workplace practices to drive employee morale and profitability</li> </ul>
Japan Airlines' Losses Mount: The Restructuring Strategies	Japan	<ul style="list-style-type: none"> <li>• Challenges to a protected company in a deregulated environment</li> <li>• Restructuring strategies</li> </ul>
Japan Airlines Corporation: Brand Building Strategies	Japan	<ul style="list-style-type: none"> <li>• Building customer confidence through branding</li> </ul>
Swiss International Airlines: Revival Plan to Yield Breakeven?	Switzerland	<ul style="list-style-type: none"> <li>• Why repositioning strategies fail?</li> <li>• Reasoning the causes of failure</li> <li>• Revival plans</li> </ul>
Swissair's 'Hunter' Strategy and the "Grounding": The Lessons	Switzerland	<ul style="list-style-type: none"> <li>• Wrong strategy vs bad strategy</li> <li>• Corporate governance – its role and importance</li> </ul>
National Pride vs Business Logic: Alitalia's Strategy within a Strategy	Italy	<ul style="list-style-type: none"> <li>• Protectionism vs business logic</li> </ul>
Transnational Alliances in Civil Aviation	–	<ul style="list-style-type: none"> <li>• Understanding the need for change and managing the change</li> <li>• Need for change in business model</li> <li>• The significance of transnational alliances</li> </ul>
Southwest Airlines: The Changing Cost Structure and Corporate Culture	USA	<ul style="list-style-type: none"> <li>• Strategic and competitive advantage erodes, if it is not properly nurtured and protected</li> <li>• Cost structure and corporate culture as a competitive advantage</li> </ul>
JetBlue Airways: Neeleman's Future Bet	UK	<ul style="list-style-type: none"> <li>• Work culture as a differentiating strategy</li> <li>• Dangers in rapid expansion strategy</li> <li>• Challenges, as the industry matures</li> </ul>
Delta Air Lines: Grinstein's Restructuring Challenge	USA	<ul style="list-style-type: none"> <li>• Perils in adopting a follower strategy</li> <li>• Merits and demerits of regional and international alliances in aviation industry</li> <li>• Strategic assessment and optimising operations</li> </ul>
AirTran Airways: The Turnaround	USA	<ul style="list-style-type: none"> <li>• Turnaround strategies</li> </ul>
US Airways and America West Merger: The Corporate Culture Integration	USA	<ul style="list-style-type: none"> <li>• Merger synergies – projected vs actual</li> <li>• Managing cultural differences in a merger</li> </ul>